

Message Text

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PAGE 01 TOKYO 10957 01 OF 03 151037Z
ACTION EA-12

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TO SECSTATE WASHDC PRIORITY 8862
INFO TREASURY/DEP WASHDC
AMEMBASSY BONN
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DEPT PASS EA FOR HEGINBOTHAM

USEEC

USOECD

E.O. 11652: N/A
TAGS: EGEN, ETRD, JA
SUBJECT: UPTURN IN JAPANESE MACROECONOMIC PERFORMANCE

REF: (A) TOKYO 5536, (B) PARIS 18851

1. SUMMARY: RECENT JAPANESE PRODUCTION AND INCOME
FIGURES SHOW GENERALLY FIRM GAINS AND PRICE TRENDS ARE
MAINLY CALM. AVAILABLE GROWTH INDICATORS THUS FAR IN
1978 HAVE BEEN MORE FAVORABLE THAN AT ANY TIME SINCE
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PAGE 02 TOKYO 10957 01 OF 03 151037Z

1976, WHEN JAPAN STILL WAS ON FRINGE OF DOUBLE-DIGIT
INFLATION. THERE IS SOME QUESTION HOW FIRM THE CON-
SUMPTION RECOVERY IS; AND VARIOUS PROBLEMS SUCH AS
STRUCTURAL DIFFICULTIES, CONTINUING HIGH UNEMPLOYMENT,
YEN RISE, AND POSSIBILITY OF FUTURE RECRUDESCENT SERIOUS
INFLATION REMAIN CONDITIONS TO BE RECKONED WITH. NEVER-
THELESS CURRENT LEVELS OF FINAL DOMESTIC DEMAND WOULD

SUPPORT A STEADY CONTINUATION OF THE RECENT ECONOMIC PATTERN. TOO, THE GOVERNMENT IS COMMITTED TO FURTHER ADAPTATION OF POLICIES IN ORDER TO CONTRIBUTE MORE TO CONTINUING RECOVERY THIS YEAR, SHOULD THIS PROVE NECESSARY. SUBSTANTIAL CONTRIBUTION OF EXTERNAL SECTOR TO GROWTH IN FIRST QUARTER 1978 SHOULD BE REVERSED DURING REMAINDER OF YEAR, AS COMPETITIVE EFFECTS OF YEN RISE CONTINUE TO MAKE THEMSELVES FELT AND JAPAN'S TRADE SURPLUS BEGINS TO DECLINE. END SUMMARY.

2. JUNE 2 ANNOUNCEMENT THAT JAPAN'S REAL ECONOMIC GROWTH RATE HAD REACHED A SEASONALLY ADJUSTED 2.4 PERCENT (ABOUT 10 PERCENT ANNUALLY) DURING THE FIRST QUARTER OF 1978 CULMINATED THE LAST SEVERAL MONTHS' ACCUMULATION OF FAVORABLE EVIDENCE ON JAPAN'S RECENT MACRO-ECONOMIC PERFORMANCE. FINAL DOMESTIC DEMAND, WHILE NOT AS A WHOVOVQUALLING THIS GROWTH RATE, REFLECTED BROAD STRENGTH IN CONSUMPTION (WHICH ROSE AT OVER 8 PERCENT SEASONALLY ADJUSTED ANNUAL RATE) AND ESPECIALLY IN PRIVATE HOUSING INVESTMENT, A COMPARATIVELY VOLATILE GROWTH COMPONENT (WHICH WAS UP APPROXIMATELY 30 PERCENT AT S.A.A.R.). PRIVATE INVESTMENT IN PLANT AND EQUIPMENT AT APPROXIMATELY 4 PERCENT S.A.A.R. SHOWED ONLY A MODEST INCREASE, BUT SEVERAL FACTORS APPEARED FAVORABLE TO FUTURE INVESTMENT. MACHINERY ORDERS ROSE SHARPLY THROUGHOUT THE QUARTER; STRONG GAINS IN INDUSTRIAL LIMITED OFFICIAL USE

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PAGE 03 TOKYO 10957 01 OF 03 151037Z

PRODUCTION DURING THE QUARTER (REACHING, AT S.A.A.R., WELL OVER 10 PERCENT) INDICATED AN INCREASING UTILIZATION OF INDUSTRIAL CAPACITY; A SIMULTANEOUS RAPID RISE IN PRODUCERS' SHIPMENTS ADDED STRENGTH TO THE PICTURE; AND STEADILY DROPPING PRODUCERS' INVENTORIES OF FINISHED GOODS APPEARED TO SIGNAL AN EARLY COMPLETION TO INVENTORY ADJUSTMENT IN MANY INDUSTRIES INCLUDING SOME - SUCH AS STEEL - WHICH RECENTLY HAVE BEEN REGARDED AS DEPRESSED. IT SHOULD BE NOTED THAT INVENTORIES OF FINISHED GOODS, ACCORDING TO GOJ SOURCES, HAVE RECEDED MORE THAN THOSE OF THE RAW MATERIALS WHICH COMPRISE A GREAT PART OF JAPAN'S IMPORTS.

3. APRIL BY CONTRAST WITNESSED ONLY A NEGLIGIBLE PRODUCTION INCREASE, DECREASES IN SHIPMENTS AND MACHINERY ORDERS, AND AN INCREASE IN INVENTORIES OF FINISHED GOODS; BUT PRECEDING GAINS FOR THESE INDICATORS HAD BEEN STRONG AND PERSISTENT ENOUGH (SHIPMENTS HAD RISEN FIVE MONTHS IN SUCCESSION AND PRODUCTION, SIX) TO SUGGEST THAT APRIL FIGURES INDICATE CORRECTION RATHER THAN REVERSAL OF UPWARD TREND WHICH HAD PREVAILED SINCE BEFORE TURN OF YEAR.

4. PRICE TRENDS REMAIN GENERALLY SUBDUED. RECENT INCREASES IN THE MONTHLY CPI FIGURES APPEAR TO REFLECT SPECIAL FACTORS RATHER THAN REKINDLED INFLATION, ALTHOUGH SITUATION IS BEING CLOSELY MONITORED BY JAPANESE GOVERNMENT. IN APRIL, A MONTH OF TRADITIONALLY HEAVY PRICE

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PAGE 01 TOKYO 10957 02 OF 03 151059Z
ACTION EA-12

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COME-00 FRB-03 INR-10 NSAE-00 XMB-02 OPIC-03
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P 151001Z JUN 78
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INFO TREASURY/DEP WASHDC
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LIMITED OFFICIAL USE SECTION 02 OF 03 TOKYO 10957

RISES, NATIONAL CONSUMER PRICE INDEX WENT UP 1.1 PERCENT FROM PREVIOUS MONTH, BUT YEAR OVER YEAR INCREASE FROM APRIL 1977 WAS LESS THAN 4 PERCENT. IN MAY THE TOKYO CPI WAS UP 0.7 PERCENT (4.3 PERCENT YEAR OVER YEAR) PARTLY BECAUSE OF INCREASED EXCISE TAXES. MEANWHILE WHOLESALE PRICES IN MAY 1978 REMAINED BELOW YEAR-EARLIER LEVEL BY 2.0 PERCENT. ACCELERATING GROWTH OF MONEY SUPPLY (M2 ROSE BY 2.2 PERCENT IN APRIL, AN EXTRAORDINARY JUMP PARTLY ATTRIBUTABLE TO UNUSUAL CIRCUMSTANCES ASSOCIATED WITH PROSPECTIVE INTEREST RATE DECLINES ON SAVINGS DEPOSITS) HAS ATTRACTED SOME ATTENTION BUT NO PUBLIC EXPRESSION OF ALARM, AND OFFICIAL CONCERN OVER INFLATIONARY DANGERS IS NOT NOW CONSPICUOUS. THERE IS NEVERTHELESS A RATHER GENERAL EXPECTATION THAT THE CURRENT LOW RATES OF INFLATION CANNOT BE IMPROVED UPON OR EVEN

MAINTAINED IN THE NEAR TERM.

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PAGE 02 TOKYO 10957 02 OF 03 151059Z

5. ACCENT IN PUBLIC DEBATE ON ECONOMIC POLICY REMAINS ON NEED TO IMPROVE BUSINESS CONDITIONS. UNEMPLOYMENT, CONTINUING AT RECORD OR NEAR-RECORD LEVELS (1,220,000 OR 2.2 PERCENT IN APRIL 1978) AND BANKRUPTCIES, REMAINING AT HIGH LEVEL DESPITE CLEAR YEAR-OVER-YEAR REDUCTIONS IN EARLY 1978 MONTHLY FIGURES (E.G. ABOUT 1,365 CASES IN MAY 1978, DOWN 17.5 PERCENT FROM MAY 1977) ILLUSTRATE INCOMPLETENESS OF RECOVERY. STRUCTURAL PROBLEMS - IN PARTICULAR, DEPRESSION IN SECTORS LIKE SHIPBUILDING AND SOME NON-FERROUS METALS - ALSO CONTINUE TO CAUSE CONCERN. IN MAY DIET PASSED LAW TO PROVIDE ADMINISTRATIVE FRAMEWORK FOR STABILIZING (ON VOLUNTARY BASIS) DEPRESSED INDUSTRIES' OUTPUT. THE HIGH YEN HAS CAUSED LESS DISRUPTION THAN HAD BEEN FEARED, BUT SEVERAL BUSINESS SURVEYS FORECAST AN EROSION OF EXPORTS LATER IN THE YEAR. ON THE POSITIVE SIDE, NEWSPAPER SURVEYS OF FIRST QUARTER EARNINGS REPORTS SHOW THAT PROFITS ON THE AVERAGE EXPERIENCED A SMALL IMPROVEMENT INSTEAD OF THE EXPECTED DETERIORATION. THIS FAVORABLE RESULT WAS ATTRIBUTED TO REDUCED INTEREST COSTS AND CURRENCY APPRECIATION GAINS ON IMPORTS.

6. JAPAN'S FISCAL AND MONETARY POLICIES REMAIN FIRMLY EXPANSIONARY. BANK OF JAPAN DISCOUNT RATE REMAINS AT POSTWAR LOW OF 3.5 PERCENT TO WHICH IT DECLINED IN MARCH. DESIRABILITY OF PREPARING SUPPLEMENTAL BUDGET WELL BEFORE FALL (TIME OF USUAL PRESENTATION TO DIET) HAS BEEN SUBJECT OF CONTINUING DISCUSSION. EFFECT OF JAPAN'S INCREASINGLY EXPANSIONARY MACRO-ECONOMIC POLICIES ON ERRATIC COURSE OF DOMESTIC DEMAND DURING LAST EIGHTEEN MONTHS IS NOT ALTOGETHER CLEAR; BUT RECENT PROGRESS IN INVENTORY ADJUSTMENT GIVES STRONG HOPE THAT THIS YEAR'S

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PAGE 03 TOKYO 10957 02 OF 03 151059Z

INTEREST RATE REDUCTIONS AND FISCAL STIMULI WILL DIFFUSE THEIR EFFECTS MORE WIDELY THROUGH THE JAPANESE ECONOMY THAN WAS THE CASE IN 1977.

7. AFTER ALMOST TWO YEARS OF WEAK EXPANSION, CONSUMPTION RECENTLY HAS SHOWN SOME SIGNS THAT MAY PRESAGE A STEADY QUICKENING OF CONSUMER DEMAND. INDICATORS SUBSEQUENT TO STRONG FIRST QUARTER PERFORMANCE, THOUGH MIXED, SHOW

CONTINUING STRENGTH. NEW CAR REGISTRATIONS APRIL AND MAY WERE OFF A LITTLE FROM THE STRONG FIRST QUARTER BUT WELL OVER YEAR EARLIER FIGURES. RETAIL STORE SALES CONTINUED TO RISE IN APRIL AFTER A GOOD FIRST QUARTER. (NON-FARM HOUSEHOLD EXPENDITURES ON OTHER HAND SHOWED ONLY MODERATE YEAR-OVER-YEAR GAINS IN MARCH AND APRIL.) GENERAL RECENT STRENGTH IN CONSUMPTION MAY WELL REFLECT GREATER CONFIDENCE IN PRICE STABILITY AMONG CONSUMERS RATHER THAN A SHORT-TERM REACTION FROM THE SLUMP OF LATE 1977. ALTHOUGH NOMINAL WAGE INCREASES RECORDED IN THIS YEAR'S SPRING LABOR OFFENSIVE WERE DOWN TO ABOUT 6 PERCENT ON AVERAGE, THEY IMPLY AN AVERAGE 1978 REAL WAGE INCREASE ABOUT THE SAME AS LAST YEAR (GIVEN LOWER DEFLATOR). THIS ALONG WITH AMPLE SAVINGS, AND INCREASINGLY STABLE ECONOMIC PROSPECTS, APPEARS TO PROVIDE SUPPORT FOR CONTINUED EXPANSION OF CONSUMPTION.

8. SUBSTANTIAL CONTRIBUTION OF EXTERNAL SECTOR TO GROWTH IN JANUARY-MARCH 1978, SHOULD NOT CONTINUE. CURRENT ACCOUNT SURPLUS, REACTING TO RAPID YEN APPRECIATION DURING 1977 AND EARLY 1978, SHOULD HAVE PEAKED IN FIRST QUARTER OF CURRENT YEAR, WHEN DOLLAR VALUE OF EXPORTS ALREADY HAD RISEN BUT WHEN ADVANTAGE WHICH HIGH YEN OFFERS TO JAPAN'S COMPETITORS HAD YET TO MAKE ITSELF STRONGLY FELT. RAPID EXPORT RISE IN FIRST QUARTER (12.1 PERCENT, S.A.) WAS FOLLOWED BY SHARP DECLINE IN APRIL. ALTHOUGH THIS APPEARS TO HAVE BEEN LARGELY A CORRECTION CAUSED BY SPECIAL

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PAGE 01 TOKYO 10957 03 OF 03 151103Z
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LIMITED OFFICIAL USE SECTION 03 OF 03 TOKYO 10957

FACTORS, WE BELIEVE THAT IT IS UNLIKELY TO BE FOLLOWED BY SUSTAINED INCREASES IN JAPAN'S TRADE SURPLUS.

9. SEASONALLY ADJUSTED IMPORTS WERE VIRTUALLY FLAT DURING JANUARY-MARCH QUARTER BUT THEY SHOWED A GAIN OF ALMOST 10 PERCENT IN APRIL. FURTHER IMPORT INCREASES ARE PROBABLE IN AT LEAST SOME SECTORS. RECENT GENERAL IMPROVEMENT OF DOMESTIC DEMAND WILL HAVE SOME BENEFITS FOR FOREIGN PRODUCERS; AND LAST FEW MONTHS HAVE WITNESSED WIDE VARIETY OF EFFORTS BY JAPAN AND HER TRADING PARTNERS TO SPEED OR INCREASE JAPAN'S ANTICIPATED IMPORT LEVELS. SUCH INCREASES WILL BE LIMITED, HOWEVER, BY WHAT JAPANESE GOVERNMENT OFFICIALS DESCRIBE AS STILL HIGH LEVELS OF RAW MATERIALS INVENTORIES.

10. UNCERTAINTIES REMAIN AS TO WHETHER JAPAN'S TRANSITION FROM PRE-OIL-SHOCK HIGH GROWTH TO STABLE "MEDIUM GROWTH," LIMITED OFFICIAL USE

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PAGE 02 TOKYO 10957 03 OF 03 151103Z

AS ENVISAGED IN THE CURRENT FIVE-YEAR PLAN AND IN CURRENT STATEMENTS OF GOJ OFFICIALS, WILL BE SUBSTANTIALLY ACHIEVED THIS YEAR. SIMILAR HOPES OF COMPLETING THAT ADJUSTMENT WERE EXPRESSED AFTER THE FIRST QUARTER OF 1976 (FOR WHICH GROWTH EXCEEDED THAT IN JANUARY-MARCH 1978) AND AFTER JANUARY-MARCH 1977 (IN WHICH GROWTH WAS ALMOST AS HIGH AS DURING THE QUARTER JUST PAST). BUT INVENTORY ADJUSTMENT IN SOME INDUSTRIES MAY NOW BE VIRTUALLY COMPLETE (PARTICULARLY IN FINISHED GOODS); GOVERNMENT POLICY--BOTH FISCAL AND MONETARY--IS NOW MORE EXPANSIONARY THAN IT WAS; THE SUBSIDING RATE OF INFLATION APPEARS TO BE CONTRIBUTING TO A RESTORATION OF CONSUMER CONFIDENCE; AND UNLIKE THE 1976 SITUATION, AT LEAST, THE GOVERNMENT IS FIRMLY COMMITTED TO FURTHER STIMULUS SHOULD THAT PROVE NECESSARY AND DESIRABLE. A GOOD CASE CAN BE MADE THAT HISTORY IS UNLIKELY TO REPEAT ITSELF THIS YEAR. MANSFIELD

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